DEPARTMENT OF STATE REVENUE

04-20120005.LOF

Letter of Findings: 04-20120005
Gross Retail Tax
For the Years 2008, 2009, and 2010

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Computer Software – Gross Retail Tax.

Authority: IC § 6-2.5-1-24; IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-8.1-5-1(c); Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Sales Tax Information Bulletin 2 (November 2011); Sales Tax Information Bulletin 8 (November 2011).

Taxpayer argues that it was not subject to sales/use tax on the monthly fee Taxpayer paid for the use of computer software.

II. Calculation Error – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer maintains that the Department of Revenue's audit report contained a calculation error which requires correction.

STATEMENT OF FACTS

Taxpayer is an Indiana electrical utility cooperative. The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit resulted in the assessment of additional sales/use tax. Taxpayer disagreed with a portion of that assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative further explained the basis for the protest. This Letter of Findings results.

I. Computer Software – Gross Retail Tax.

DISCUSSION

The Department's audit found that Taxpayer owed additional sales/use tax. The audit assessed tax on charges related to computer software. The taxes related to a "Member Software and Service Agreement." This agreement provides for the licensing of software and related support services.

Insofar as the licensing of this software, the agreement provides as follows:

> Subject to the limitations contained in this agreement, [Vendor] hereby grants to [Taxpayer] for the term of this contract, a limited term, non-exclusive license to use the version of software. [Taxpayer] may use the licensed software for its use in the normal operation of its business. The license hereby granted is personal to [Taxpayer] and non-assignable by [Taxpayer] without prior written approval of [Vendor].

The agreement promises to provide Taxpayer with "[m]achine-readable programs for supported platforms.

The same agreement also provides for computer support services as follows:

> For the term of the agreement, [Vendor] shall provide support to [Taxpayer] including any changes or enhancements made to the software for the applications. [Vendor] shall make such changes and enhancements available to [Taxpayer] as they are generally available to other [customers] of [Taxpayer] who are using the licensed software under a like agreement.

It is important to understand that Vendor charges Taxpayer various costs related to its contract with its Vendor. Taxpayer pays money for the use or licensing of the software; Taxpayer pays money for charges related to the update and maintenance of the software.

Taxpayer has no quarrel with paying sales tax on that portion of the invoice related to the agreement providing software maintenance. Taxpayer points to Sales Tax Information Bulletin 2 (November 2011), 20111228 Ind. Reg. 045110764NRA, as follows:

> In the case of software maintenance agreements or optional warranties, the presumption is that tangible personal property in the form of updates will be transferred. Software maintenance agreements and optional warranties are presumed to be subject to sales and use tax. This presumption can be rebutted if the taxpayer can demonstrate that no updates were actually received. See also Sales Tax Information Bulletin 2 (December 2006), 20100804 Ind. Reg. 045100497NRA ("Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided.")

Taxpayer's argument is that sales tax was not due on that portion of the Vendor's invoice which related to "base fee," "user fee," "license fee," or "fixed agreements." In other words, these are the costs which Vendor charges for the use of this particular software package and not the maintenance costs.

Taxpayer bases its argument on the terms of the contract it has with the Vendor. Taxpayer explains that it

"can demonstrate, by contract, the payment of User Fees presumes no updates, only use of software service...." Taxpayer maintains that if it was not entitled to software updates, then it is not required to pay sales/use tax on the use or licensing of the software. Taxpayer is mistaken because Taxpayer is conflating issues related to the purchase of software and the purchase of software maintenance services; Taxpayer is comparing apples and oranges. The issue of whether or not software updates are provided is relevant in determining if a maintenance contract is exempt. As stated in the Information Bulletin, in the case of "software maintenance agreements or optional warranties," the transactions are presumed to be taxable unless the Taxpayer can demonstrate "that no updates were actually received." Sales Tax Information Bulletin 2 (November 2011).

Taxpayer's quarrel is with the imposition of sales tax on the licensing or use of the computer software. Whether or not updates are received is not relevant in determining the taxability of licensing or purchase of computer software.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Rhoade, 774 N.E.2d at 1047; USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466, 468–69 (Ind. Tax Ct. 1993).

To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Rhoade, 774 N.E.2d at 1048. Indiana law states that computer software constitutes "tangible personal property." IC § 6-2.5-1-27 specifies that:

"Tangible personal property" means personal property that:

(1) Can be seen, weighed, measured, felt or touched; or

(2) Is in any other manner perceptible to the senses.

The term includes electricity, water gas, steam, and prewritten computer software. (Emphasis added).

"Prewritten computer software" is defined in IC § 6-2.5-1-24 as follows:

Subject to the following provisions, "prewritten computer software" means computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser:

(1) The combining of two (2) or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be other than prewritten computer software.

(2) Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser.

(3) If a person modifies or enhances computer software of which the person is not the author or creator, the person is considered to be the author or creator only of the person's modifications or enhancements.

(4) Prewritten computer software or a prewritten part of the software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software. However, where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such a modification or enhancement, the modification or enhancement is not prewritten computer software.

The Department has provided guidance in determining whether computer software is subject to the state's sales/use tax.

[P]rewritten programs (i.e., canned software) not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property, and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Prewritten or canned computer programs are taxable because the intellectual property contained in the canned program is no different from the intellectual property in a videotape or a textbook. Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA.

Taxpayer takes issue with the imposition of sales/use tax on the payment of software license fees. In this particular case, Taxpayer has acquired packaged computer software for use in its utility business. The computer software is marketed to a variety of different utility companies and is essentially "canned" software. Under IC § 6-2.5-1-27, this canned software constitutes "tangible personal property" which was acquired in a retail transaction and is subject to the state's use tax.

Taxpayer has failed to meet its burden of establishing that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person

against whom the proposed assessment is made."

FINDING

Taxpayer's protest is respectfully denied.

II. Calculation Error – Gross Retail Tax.

DISCUSSION

Taxpayer argues that the audit report contains a calculation error on page seven. According to Taxpayer, a single transaction is listed twice. The report does have a reference number 151963 listed twice. The reference number does refer to the same vendor, National Information Solutions Cooperation." and both references contain an identical description to the transaction. However the amount of the transaction is not identical.

Taxpayer asks that the report be corrected to eliminate what it believes is a duplicate entry.

An administrative hearing is not proper setting to determine matters best left to the Department's audit division. However, Taxpayer has provided sufficient information pursuant to IC § 6-8.1-5-1(c) necessary to establish that the report should be reviewed and that any adjustment based on Taxpayer's explanation be made.

FINDING

Taxpayer's protest is sustained subject to audit review and verification.

SUMMARY

The audit division is requested to review the purported duplicate entry on page seven of the audit report and to make whatever correction it deems appropriate; in all other respects, Taxpayer's protest is denied.

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